

STATE OF ALABAMA
DEPARTMENT OF INSURANCE
MONTGOMERY, ALABAMA

REPORT OF

LIMITED SCOPE EXAMINATION

OF

ALFA SPECIALTY INSURANCE CORPORATION

MONTGOMERY, ALABAMA

AS OF

DECEMBER 31, 2004

PARTICIPATION:

SOUTHEASTERN ZONE, NAIC

ALABAMA

EXAMINER'S AFFIDAVIT AS TO STANDARDS AND
PROCEDURES USED IN AN EXAMINATION

State of Alabama,
County of Montgomery,

Jack M. Brown, CFE, being duly sworn, states as follows:

1. I have authority to represent the State of Alabama, Department of Insurance in the examination of Alfa Mutual Insurance Company.
2. The Alabama Department of Insurance is accredited under the National Association of Insurance Commissioners Financial Regulation Accreditation Standards.
3. I have reviewed the examination work papers and examination report, and the examination of Alfa Mutual Insurance Company was performed in a manner consistent with the standards and procedures required by National Association of Insurance Commissioners and State of Alabama.

The affiant says nothing further.

Jack M. Brown
Examiner's Signature

Subscribed and sworn before me by Jack M. Brown on this 22nd day
of July, 2005.

(SEAL)

Charlene H. Williams
Notary Public

My commission expires 6-5-07 [date].

EXAMINATION AFFIDAVIT

STATE OF ALABAMA
COUNTY OF MONTGOMERY

Matthew P. Merlino, being first duly sworn, upon his oath deposes and says:

That he is an examiner appointed by the Commissioner of Insurance for the State of Alabama;

That an examination was made of the affairs and financial condition of Alfa Specialty Insurance Corporation for the period of January 1, 2002 through December 31, 2004;

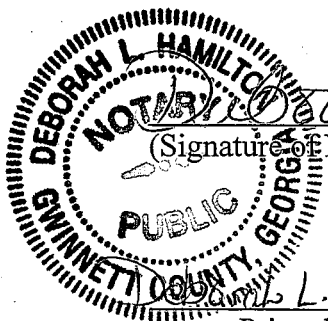
That the following 6 pages constitute the report thereon to the Commissioner of Insurance for the State of Alabama;

And, that the statements, exhibits, and data therein contained are true and correct to the best of his knowledge and belief.



Matthew P. Merlino
Examiner

Subscribed and sworn to before the undersigned authority this 20th day of July 2005.



Deborah L. Hamilton
(Signature of Notary Public)

Deborah L. Hamilton, Notary Public
Printed Name

in and for the State of Georgia

My commission expires April 5, 2009

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Montgomery, Alabama
July 20, 2005

Honorable Mike Geeslin
Chairman, Examination Oversight Committee
Commissioner, Texas Department of Insurance
P.O. Box 149104
Austin, Texas 78714-9104

Secretary, Southeastern Zone
Honorable Walter A. Bell
Commissioner
Alabama Department of Insurance
201 Monroe Street, Suite 1700
Montgomery, Alabama 36104

Dear Commissioners:

Pursuant to your instructions and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners, a limited scope financial examination as of December 31, 2004, has been made of

ALFA SPECIALTY INSURANCE CORPORATION

The report of examination is submitted herewith. Where the description "Company" or "ASI" appears herein, without qualification, it will be understood to indicate Alfa Specialty Insurance Corporation.

SCOPE OF EXAMINATION

This examination reported herein covers the period ending December 31, 2004, and has been conducted by actuarial examiners representing the Alabama Department of Insurance. The Company's insurance affiliates (six property and casualty companies) have been examined concurrently with the examination of the Company. Events subsequent to December 31, 2004, have been reviewed as required and are reported herein as deemed appropriate.

The Company has been examined in accordance with the statutory requirements of the Alabama Insurance Code and the regulations and bulletins of the Alabama Department of Insurance; in accordance with the applicable guidelines and procedures of the NAIC; and in accordance with generally accepted actuarial standards.

The examination included a limited scope review of the Company and its affiliated insurance companies' loss and loss expense reserves in their 12/31/2004 Statutory Annual Statement. A review of the Company's reinsurance protection for catastrophic losses and recently implemented plan to reduce its hurricane catastrophe exposure was also conducted. This limited review included a review of the Company's compliance with statutes and regulations regarding loss and loss adjustment expenses.

Within this report, discussion of the Company's accounts has been confined to those reserve items for which comments and/or recommendations have been made.

ORGANIZATION AND HISTORY

The Company was incorporated on August 11, 1999, as a wholly-owned subsidiary of Alfa Mutual Insurance Company (AMI). The initial marketing plan for the Company, which is also currently in effect, is the writing of non-standard automobile insurance in Alabama, Georgia and Mississippi.

The Company's Articles of Incorporation authorized 10,000,000 shares of common stock of a par value of \$.05 per share and 1,000,000 shares of preferred stock of a par value of \$.10 per share. No preferred stock had been issued as to the date of this examination.

The Company's initial capitalization derived from the issue of 10,000,000 shares of its common stock, to AMI, for a price of \$15,000,000, providing \$500,000 of paid up capital and \$14,500,000 of paid in surplus.

The Company is affiliated with five other property and casualty insurers, which are participants in a reinsurance pooling agreement. The terms of the agreement provide that all direct business of the affiliates will be ceded to AMI. The pooled business is then retroceded according to percentages provided in the pooling agreement. In 1989, an intercompany reinsurance pooling committee, representing the boards of directors of the reinsurance pool participants, was established. This committee is responsible for reviewing and approving any changes to the

pooling agreement, to assure that transactions are fair and equitable to all pool participants, and to monitor potential or actual conflicts of interest between pool participants. The Company became a participant in the reinsurance pooling agreement in 2001.

On July 23, 2001, the Company's Articles of Incorporation were amended to change the par value of its common stock from \$.05 to \$.10 per share. Subsequent to this action \$500,000 was transferred from paid in surplus to capital. At December 31, 2001, the Company's paid up capital was \$1,000,000, consisting of 10,000,000 shares of common stock of a par value of \$.10. Paid in surplus amounted to \$14,000,000.

REINSURANCE

Intercompany Reinsurance Pooling Agreement

This agreement was effective August 1, 1987, between Alfa Mutual Insurance (AMI) and its affiliates: Alfa Mutual Fire Insurance Company (AMF); Alfa Mutual General Insurance Company (AMG); Alfa Insurance Corporation (AIC); and, Alfa General Insurance Corporation (AGI). Alfa Specialty Insurance Corporation (ASI), incorporated in 1999, was added to the pool in 2001. These participants in the pooling agreement will be referred to as "the affiliates" for the remainder of this discussion. This reinsurance pooling agreement was filed with the Alabama Department of Insurance on July 29, 1987, and was subsequently approved.

Per Note 26 to Financial Statements, the affiliates cede 100% of the net liabilities for net premiums written and the Company retains or retrocedes the pooled business in accordance with the following percentages:

Company	8/1/1987 Pool 1	10/1/1994 Pool 2	10/1/1996 Pool 3	1/1/2001 Pool 4
AMI	32.0%	24.0%	32.0%	18.0%
AMF	15.0%	8.0%	0.0%	13.0%
AMG	3.0%	3.0%	3.0%	3.0%
AGI	25.0%	32.5%	32.5%	32.5%
AIC	25.0%	32.5%	32.5%	32.5%
ASI	0.0%	0.0%	0.0%	1.0%

Reinsurance Assumed

As of December 31, 2004, the Company did not assume reinsurance except through the intercompany reinsurance pool.

Reinsurance Ceded

As of December 31, 2004, the Company did not cede reinsurance except through the intercompany reinsurance pool.

Catastrophe Reinsurance Protection and Recently Implemented Plan to Reduce Hurricane Exposure

We have reviewed the Company's reinsurance protection for catastrophes and its recently implemented plan to reduce its exposure to severe hurricanes. We have concluded that the combination of the reinsurance protection and plan to reduce its catastrophe exposure is sufficient to protect its financial solvency.

In Alfa Group's catastrophe program, the allocation percentages for catastrophes are reviewed annually and changed if required. The current catastrophe losses are allocated as follows:

Effective January 1, 2003 – December 31, 2003

Range	AMI	AMF	AMG	AIC	AGI	ASI
\$0 to \$12,125,000	18.00%	13.00%	3.00%	32.50%	32.50%	1.00%
\$12,125,001 to \$301,500,000	51.40%	37.10%	8.60%	0.00%	0.00%	2.90%
\$301,500,001+	43.20%	35.00%	3.00%	9.00%	9.00%	0.80%

Effective January 1, 2004 – December 31, 2004

Range	AMI	AMF	AMG	AIC	AGI	ASI
\$0 to \$14,200,000	18.00%	13.00%	3.00%	32.50%	32.50%	1.00%
\$14,200,001 to \$352,000,000	51.40%	37.10%	8.60%	0.00%	0.00%	2.90%
\$352,000,001+	44.18%	34.36%	2.93%	8.89%	8.89%	0.75%

STATEMENT OF LIABILITIES, SURPLUS, AND OTHER FUNDS

Reserve for Unpaid Losses	<u>\$2,134,562</u>
Reserve for Unpaid Loss Adjustment Expenses	<u>\$362,834</u>
Reserve for Unpaid Losses – Direct and Assumed	<u>\$3,697,000</u>
Reserve for Unpaid Loss Adjustment Expenses – Direct and Assumed	<u>\$363,000</u>

Based on our review of the support for the amounts carried by the Company on these lines, we believe these amounts:

- A. Meet the requirements of the insurance laws of Alabama;
- B. Are computed in accordance with accepted loss reserving standards and principles; and,
- C. Make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its contracts and agreements.

The Company makes a practice of carrying reserves in excess of both the Appointed Actuary's and Company employed actuary's indications without quantitative support for the difference. Based on our review, we believe that the amount by which the Company carries reserves in excess of supported indications is not material.

Reserves for losses related to Hurricane Ivan Catastrophe

We reviewed the reserves carried by the Company as of 12/31/04 related to Hurricane Ivan and believe that they will ultimately prove to be sufficient to cover all related losses. Additionally, based on our review of the Company's reserves and financial position, any potential adverse development related to the storm will not be material to the Company's financial position.

We have reviewed the Company's recent plan to mitigate its exposure to severe hurricanes. We believe that the Company's reinsurance program and plan to mitigate its exposure to severe hurricanes is sufficient to protect the Company from any reasonable foreseeable hurricanes.

Premium Deficiency Reserves

We have reviewed the premium deficiency reserves carried by the Company per Note 30 to Financial Statements. Per this note, the Company carries \$0 before intercompany pooling and \$3,061 after pooling. In our opinion, this does not constitute a material examination issue.

COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

It appeared that the Company had complied with all reserve related recommendations in the examination report as of December 31, 2001.

COMMENTS AND RECOMMENDATIONS

We have no recommendations related to the Company's carried reserves as of December 31, 2004 or related to the Company's catastrophe reinsurance and catastrophe mitigation plan.

We do recommend that the Appointed Actuary provide the report supporting his Statement of Actuarial Opinion by May 1 per the 2004 NAIC Annual Statement Instructions.

CONCLUSION

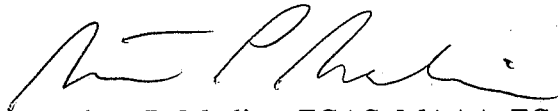
Acknowledgement is hereby made of the courtesy and cooperation extended by representatives of **Alfa Specialty Insurance Corporation** during this examination.

The customary examination procedures, as recommended by the National Association of Insurance Commissioners, have been followed to the extent appropriate in connection with the verification and valuation of assets and the determination of liabilities set forth in this report.

Examination findings indicated that the Company was in sound financial condition as of December 31, 2004.

In addition to the undersigned, the following persons represented the Alabama Department of Insurance as participants in this examination: Jack Brown, CFE, CIE, Examiner; Matthew P. Merlino, FCAS, MAAA, FCA, Examiner, Robert P. Daniel, ACAS, MAAA, and Bao Vu.

Respectfully submitted,
July 20, 2005



Matthew P. Merlino, FCAS, MAAA, FCA
Examiner
Alabama Department of Insurance